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TAGS: [EINV](#) [ECON](#) [OECD](#) [JA](#)

SUBJECT: METI STUDY GROUP CRACKS DOWN ON TAKEOVER DEFENSES

REF: A. TOKYO 1353

[1](#)B. 07 TOKYO 3689

[1](#)C. TOKYO 546

[1](#)D. TOKYO 1550

Classified By: Charge D'Affaires James P. Zumwalt. Reason 1.4(b)(d)

[1](#)1. (C) Summary: The Ministry of Economy, Trade and Industry (METI) Corporate Value Study Group (CVSG) has produced a long-awaited report on the appropriate use of corporate takeover defenses that includes a strong statement about the positive impact of M&A, even in cases of hostile deals, on corporate value. The report urges companies to use defensive measures sparingly, and not for entrenching management at the expense of shareholder interests. Although the study group's role is strictly advisory, METI's Director of Corporate Systems says the GOJ will examine the report's conclusions and consider possible legal and regulatory changes. Other observers expect the report to have an impact on corporate behavior and, over time, facilitate increased M&A activity in Japan. End Summary.

[1](#)2. (C) The Corporate Value Study Group report, "The Use of Takeover Defense Measures in Light of Recent Changes in the Investment Climate," represents a consensus of interested parties, including both investors and corporate executives, according to Hiroaki Niihara, Director of METI's Corporate Systems Division, which oversees the study group's deliberations. Investor groups, especially institutional investors, have been increasingly vocal in demanding better corporate governance from Japanese firms (Ref A). Japanese corporate executives (and senior METI officials) have sought a strong statement against defensive measures; e.g. compensation payments to hostile bidders, such as occurred in the July 2007 Bull-Dog Sauce, Co. case (Ref B). The new

report does both.

Defenses Must Protect Shareholder Interests

¶3. (SBU) The report sets out four broad principles CVSG members believe should guide the adoption and implementation of corporate takeover defenses. First, defenses ultimately must protect shareholders' interests. Second, takeovers, even if hostile, have a potentially positive impact on a target company since they instill discipline in managers and enhance "the common interests of shareholders and management in increasing corporate value." Third, management must bear in mind when considering corporate defense measures that implementation of such steps deprives shareholders who support the takeover bid (TOB) of the opportunity to sell their shares to a potential acquirer. Fourth, use of takeover defenses for the purpose of entrenching management is never acceptable.

Directors, Not Outsiders, Must Judge Bids

¶4. (SBU) Building from these principles, the report sets out practical guidelines for directors to follow when presented with a proposed bid for their company. Key among these is the responsibility of directors to make a clear and unambiguous determination on the adoption and implementation of any takeover defense, and to explain that decision to shareholders. Many "advance warning" defenses as adopted by

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Japanese firms allow a board to appoint an "outside committee" to analyze a TOB and advise the board on whether to invoke takeover defenses. Institutional investors and the American Chamber of Commerce in Japan (ACCIJ) have sharply criticized this practice, arguing these outside committees are not truly independent and are not subject to the same fiduciary duties to shareholders as directors. The CVSG has now endorsed this position.

¶5. (SBU) The report further finds a target company's board is obligated under their duty to care for shareholders to issue a clear judgment about whether an offer is in the shareholders' best interests. The board also must clearly explain its judgment to the shareholders. If directors evade this responsibility by turning the evaluation of a takeover bid over to a committee of outside experts -- as several firms have done in recent years, most recently Sapporo Holdings (Ref C) -- this "can be considered an evasion of responsibility" in the CVSG's view. Nevertheless, "whatever decision the board takes, the final judgment on any takeover bid should be made by shareholders," the report concludes.

Poison Pills Should Encourage Talks, Not Block Bids

¶6. (SBU) The panel also addressed "poison pill" rights plans, which was the point of contention in the Bull-Dog Sauce case. In that case, the company issued warrants to all shareholders except the hostile bidder and then compensated the bidder with a cash payment at a price per share equal to the takeover bid. Since this cash payout equaled three years' worth of the firm's operating profit, it forced the company to report its first-ever operating loss.

¶7. (SBU) Many observers, including senior METI officials, criticized Bull-Dog's cash payment as "greenmail", although the Supreme Court later found the approval of the rights plan to be within the rights of shareholders to decide and consistent with Japan's Company Law that requires "equal treatment" for all shareholders. The CVSG report, in effect, repudiates that ruling, noting payment of cash, or cash equivalent, to a hostile acquirer is not required under Japan's Company Law. In the U.S., the report notes, the aim of a poison pill is to press a potential acquirer to

negotiate with the target, not to block the deal. But Japanese poison pills, which include provision for paying a hostile acquirer to drop its bid, could reduce the incentive for the acquirer to negotiate seriously or to sweeten its bid, the report concludes.

METI Actively Promoting the Report

18. (C) METI Director Niihara has actively promoted the CVSG's report since its release. He recently spoke before a Tokyo M&A Conference sponsored by the Economist Intelligence Unit and subsequently lectured more than 200 financial analysts at a seminar sponsored by Nikko Citigroup. Niihara is also scheduled to brief a Japanese business audience later this month at a METI policy research institute.

19. (C) Niihara's message has been consistent in all these fora. He emphasized the report "represents the wisdom of leading experts in the field of M&A, and a cross-section of

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corporate leaders, academics and financial analysts." The Ministry of Justice, the Financial Services Agency and Tokyo Stock Exchange as CVSG observers also support the group's conclusions, he added. Niihara said METI had recognized growing "miscommunication" between investors and company managements and so reconvened the CVSG in late 2007 to address two questions: What are the legitimate forms for defensive measures consistent with the role of international capital markets in providing risk capital to Japanese business? And, what are the integral aspects of corporate defenses from a public policy perspective? METI had been concerned that many of the defenses measures adopted by listed companies are inconsistent with CVSG guidelines issued in 2005. Based on the new report, Niihara told the Nikko audience the GOJ will begin internal discussions on whether changes to Japan's laws or regulations are needed.

Expert Reaction Largely Positive

110. (C) Public reaction to the CVSG report has been largely positive. A CVSG member and senior manager of a European investment bank told Econoff he believes the report has cleared away the remaining confusion over the appropriate structure and use of defensive measures that arose after the Bull-Dog Sauce ruling. He credited Niihara with leading the Study Group in a positive direction and working behind the scenes in late 2007 to modify the group's membership to be more pro-investment. The banker anticipates the report will be well received by investors and, over time, will facilitate M&A activity.

111. (SBU) Nikko Citigroup senior equity analyst and CVSG member Tsutomu Fujita also praised the report. In a recent letter to clients, Fujita said although CVSG reports have no binding legal force, he expects "at the least, Japan's leading companies will respect the report's contents" as it was compiled with the assistance of representatives of Keidanren representative and several Japanese blue-chip firms. Fujita believes the group's findings, combined with new strategies followed by activist funds at this year's annual general shareholder meetings (Ref D), will lead to gradual changes in corporate behavior, just as the CVSG's 2005 guidelines opened the door to a wave of poison pills and other defenses.

112. (SBU) Professor Osugi of Chuo University, another CVSG member and an expert on Japan's Company Law, told the press not all CVSG members may be fully satisfied with the outcome, but the report represents a broad consensus. He also praised METI's Niihara, as the CVSG's Secretariat, for his efforts toward a positive outcome.

¶13. (C) The Chairman of the ACCJ's Foreign Direct Investment Committee agreed the report was generally positive and hoped it would lead quickly to changes to the Japan's Company Law to improve corporate governance and clarify the role of independent directors on corporate boards. The ACCJ, he said, plans to issue a "Viewpoint" position paper in the near future commending the CVSG report and laying out steps the GOJ can take to improve further Japan's M&A climate.

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¶14. (SBU) Yutaka Suzuki, a researcher with the respected Daiwa Institute, writing on his economics blog, expressed concern the CVSG report, by including a strong statement against excessive use of defensive measures, gives the impression hurdles for the invocation of defensive measures have been lowered. However, overall, he praised the CVSG for emphasizing that a fair and appropriate decision by a firm's board of directors is a pre-requisite for introducing defensive measures. A financial journalist, Hideki Morioka of the Fuji-Sankei newspaper, commended the CVSG report for recognizing management and shareholder interests can be synonymous, and emphasizing the importance of management and shareholders cooperating to maximize corporate value.

Comment

¶15. (C) The CVSG report is particularly welcome for its unequivocal statement in support of shareholders having the final say on any takeover bid. The report also undermines the outdated notion that Japan has a "stakeholder" rather than a shareholder model of capitalism. While the report's findings may take time to affect practical changes in corporate behavior, they will likely have an eventual, positive impact on Japan's M&A climate if, as expected, they lead to regulatory or legal changes. In the meantime, the report supports domestic and foreign investors' calls for continued improvements to Japan's system of corporate governance.

ZUMWALT